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Project Report

BRITISH COLUMBIA FINANCIAL REVIEW: THE ISSUE OF FORECASTING AND FISCAL PLANNING

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Executive Summary—Forecasting and Fiscal Planning

This report looks in detail at the policies and procedures followed by the Province to prepare its budget and deficit/surplus forecasts. A number of weaknesses in the process were identified, including:

- The trend toward aggregating expenditures into fewer votes.
- The virtual absence of independent program evaluations to inform the budgeting process.
- Inconsistencies in reporting procedures across ministries.
- Inadequate communication of relevant information.

The report recommends:

- The expansion of multi-year forecasting to encourage ministries to take a longer view of their programs and activities.
- The expansion of central planning and economic analysis to coordinate government policy and priorities within the budget and fiscal framework.
- Greater emphasis be placed, during budget preparation, on identifying lurking expenditures and on micro-level factors affectiing the fiscal future.

The Issue of Forecasting and Fiscal Planning

A. Introduction and summary

1. Overview

The Ministry of Finance and Corporate Relations is responsible for managing the fiscal direction of the province. Among a variety of functions, this process involves the preparation of an annual budget and a medium term plan referred to as the Fiscal Framework.

Our financial review of the province involved an evaluation of the forecasting capabilities and fiscal planning of the province. To address the issue we focused on the activities of the Economics and Policy Division and Treasury Board Staff and we met with individuals from other areas of the government where necessary.

The Fiscal and Economic Analysis Branch, within Economics and Policy Division, is responsible for producing the province's revenue and economic forecast for the annual budget and the Fiscal Framework. The Branch is also responsible for on-going monitoring of actual revenue and expenditures relative to budgeted amounts. Treasury Board staff prepare the Estimates, the Supplement to the Estimates, and the forecast of expenditures used in the Fiscal Framework.

Based on our review and analysis, we conclude that the mechanics of preparing and monitoring the budget process is thorough and effective. However, we have some concerns regarding the general policies that are followed regarding the coordination of goals and preparation of the budget. Furthermore, we have recommended changes regarding medium and long term forecasting by the province.

2. Summary of recommendations

As a result of our review of the forecasting and fiscal planning issue our report includes the following recommendations:

► The Adequacy of Government's Medium to Long-Term Fiscal Planning

The Macro Approach to the Medium-Term Forecast

We recommend:

- The Fiscal Framework procedure be expanded to look at micro as well as macro forces that will impact the future fiscal position and direction of the province. This could possibly involve an expansion of the process established this year in the budget instructions. The forecast would then be updated by the ministries during the summer months for inclusion with the Fiscal Framework.

- Implementing a policy of producing a five year budget, which will have the additional benefit of forcing individual ministries to improve their approach to medium term budgeting as well as improving the planning and forecasting ability of the Province.

Lurking Expenditures

We recommend:

- Procedures be put in place to identify potential future costs and obligations and to present alternatives on minimizing such costs. Cost identification would require a process of "auditing" the ministries' budget forecasts several times a year. The branch responsible for budget "audits" logically would be in Treasury Board staff.

- Estimates of future costs would require appropriate verification and any increase in the level of service provided would require justification.

The Absence of a Central Policy Group

We recommend:

- A Cabinet planning committee be established to formulate the goals of government, translate the goals into policies and ensure the budget process is framed around the stated government policies.

- The Adequacy of the Procedure Followed to Forecast the Province's Budget Deficit

The recent trend in British Columbia's budget deficit.

We recommend:

- Steps be undertaken immediately to revise the balanced budget plan and develop a framework to correct the current imbalance between revenues and expenditures.

- The plan be developed within a longer-term strategic economic framework.

Zero-Based Budgeting

We recommend:

- A review be performed to determine the extent to which other jurisdictions are using zero-based budgeting, the degree of success experienced, the methods being used and an analysis of alternative strategies to apply zero-based budgeting, or a similar process, to British Columbia's budget formulation.

The Fiscal and Economic Analysis Branch

We recommend:

- Additional resources be added, or a restructuring undertaken, to strengthen the relationship between annual budget formulation and overall government policy-making and priority setting.

The Trend to Aggregation of Expenditures into Fewer Votes

We recommend:

- A review of the number of votes allowed per ministry and the degree of detail provided in the vote; and

- As an alternative to the above, a review of the process required to re-allocate spending within a vote.

Procedure for Forecasting Expenditures with Statutory Authority

We recommend:

- All statutory expenditures be included in the annual budget. Estimates should be based on the most likely annual expenditure, given historical experience and current events.

Location and Independence of Planning and Statistics Division

We recommend that:

- Consideration be given to moving the Planning and Statistics Division to 617 Government Street in Victoria. If insufficient space is available for the entire division to move, a review of the benefits and costs of moving only the Quantitative Analysis Branch should be undertaken.

- Those staff in the Quantitative Analysis Branch that are involved in the budget process should be excluded personnel.

Ministry Expenditure Reporting

We recommend:

- Resources be applied to establishing consistent reporting systems across government ministries. The government-wide financial systems initiative; GASSP, is one which we support. This issue is dealt with in more detail in the issue paper on Accounting Policies.

B. Description

1. Primary and subsidiary issues

The government's forecast of its fiscal position is perhaps its most important tool for managing British Columbia's economy. Reliable forecasts assist the government in assessing and comparing new programs, indicate the overall thrust of its fiscal policy, anticipate spending pressures in various ministries, manage the province's borrowing and cash requirements, evaluate revenue measures, determine its revenue capacity and identify a structural imbalance between expenditures and revenues.

This report addresses two primary issues regarding forecasting:

- ► The adequacy of government's medium to long-term fiscal planning.

- The adequacy of the procedure followed to forecast the province's budget deficit.

C. Government policies

1. Balanced budget plan

During March, 1991, a balanced budget and debt reduction plan was implemented in the form of the Taxpayer Protection Act. The Act included:

- a freeze on provincial tax rates for a three-year period.
- a Balanced Budget Plan tabled by government in which the budget is balanced over a five-year period.
- spending growth limited to the rate of growth in the provincial economy over a five-year period.
- a Balanced Budget Progress Report, beginning in 1992, and an annual Debt Reduction Plan to be tabled by government.

Exhibit I
Balanced budget plan ($ billions)

	1991/92	1992/93	1993/94	1994/95	1995/96	Five Year Total
Revenue	15.3	16.5	17.6	18.7	20.0	
Expenditure	16.5	17.3	17.8	18.4	18.9	
Surplus (Deficit)	(1.2)	(0.8)	(0.2)	0.3	1.1	(0.8)
Budget Stabilization Fund Transfer	0.8	0.0	0.0	0.0	0.0	
General Fund Surplus (Deficit)	(0.4)	(0.8)	(0.2)	0.3	1.1	0.0
Revenue as a Per Cent of GDP	19.0*	18.0	18.0	18.0	18.0	
Expenditure as a Per Cent of GDP	19.5	18.9	18.2	17.7	17.0	

* *Revenue includes the Budget Stabilization Fund transfer in 1991/92.*

a) Revenue

Under the Balanced Budget Plan, revenues in each year were set to equal approximately 18 per cent of provincial nominal Gross Domestic Product (GDP), while expenditure levels were established for each period to generate a zero cumulative balance. The Balanced Budget Plan revenue projection assumed the following:

- Total revenue, excluding Budget Stabilization Fund transactions, remains at its level of 18 per cent of nominal GDP in each of the five years covered by the Plan.

- Canada Assistance Plan recoveries would not be capped until 1992/93.

- The British Columbia Hydro and Power Authority would increase electricity rates an average of 4.5 per cent per year resulting in higher annual dividends to the province.

- Federal limitations on contributions for Established Programs Financing and the Canada Assistance Plan would end in 1994/95.

In his budget speech, the then Minister of Finance and Corporate Relations stated that an increase in taxes may be required to meet the revenue target if the Supreme Court of Canada overturned British Columbia's appeal regarding its entitlements for Canada Assistance Plan transfers Although not publicly stated at that time, it was clear that new revenue measures would be required to meet the revenue target regardless of the decision of the Supreme Court, as the historical relationship between nominal GDP and revenue was developed using revenue data that were not adjusted for the additions over time of new revenue measures.

Three further changes have transpired that will ensure, in the absence of revenue measures, the Balanced Budget Revenue targets will not be realized in 1991/92 and beyond. These are:

- The rate adjustment anticipated for B.C. Hydro in mid-1991 did not materialize.

- The decision of the Supreme Court of Canada which allows the federal government to limit payments to the province under the Canada Assistance Plan (a loss in 1991/92 estimated at $156 million).

- A change in the assumptions regarding the continuation of the federal limitations on contributions for Established Programs

Financing and the Canada Assistance Plan into 1995/96 (loss estimated at $850 million in 1995/96).

b) Expenditures

The expenditure track in the May, 1991 Balanced Budget Plan was designed to balance the General Fund over five years based on the projected revenue track. The Plan shows a substantial decline in spending growth, from 8.1 per cent in 1991/92 to 4.3 per cent in 1992/93 and 2.7 per cent in 1995/96. As a result, expenditure as a percentage of GDP would drop from 19.5 per cent in 1991/92 to 17 per cent in 1995/96.

To maintain the 1991/92 deliveries of programs and services in the areas of health, education and social services, stated as "the number one priority" in the May 1991 Budget speech, implied restrictions would have been required in the growth rate of other government expenditures. Nevertheless, the government had previously announced significant **new** programs that would be implemented over the Balanced Budget Plan forecast period, including:

- Freedom to Move Special Account: $3.5 billion for transportation.
- Forest Renewal Plan: $1.4 billion for reforestation.
- Science and Technology Fund Special Account: $420 million for science and technology initiatives.

In October 1991, the Ministry of Finance and Corporate Relations produced a status quo forecast of expenditures for the five years ending 1995/96 based on government honouring its existing expenditure commitments, but not allowing for new programs or new revenue measures. It also does not provide for new program initiatives, native land claims, the KAON project or flood relief. The expenditure forecast indicated a growth rate of 9.1 per cent in 1992/93 (from the 1991/92 Estimates), declining to 7.5 per cent in 1995/96. The status quo forecast exceeded spending under the Balanced Budget Plan by $9.7 billion over the five-year forecast period.

c) Summary

The Balanced Budget Plan tabled in the Legislature with the 1991/92 Estimates was more a best hope than a plan to lead British Columbia to a balanced budget. The relationship of revenues to nominal GDP required on the inclusion of unspecified new revenue measures. Further, by maintaining the same level of delivery of health, education and social services programs, the Plan implied substantial expenditure restrictions in other areas of government; but with no description of how or where they would occur. Therefore, even if the targets were achievable, no process was put in place to decide which programs should be terminated and/or which services could be reduced. Essentially, no plan or

procedure existed that: scrutinizes the expenditures of Ministries on a value-added basis; fully identifies funding pressures that are building and that will have to be dealt with in the future by the government; and sets the framework through which the objectives of government's policies are coordinated with its revenue and expenditure targets. In short, while more or less adequate from a traditional budget preparation perspective the means to achieve the announced objective of a balanced budget did not exist.

D. The budget management system

1. Fiscal forecast

a) Economic forecast

The economic forecast prepared by the Fiscal and Economic Analysis Branch is a critical component of the the Fiscal Framework and budget forecast. The economic forecast is used by the Ministries in their estimates of revenues and expenditures as well as in the forecast of tax revenue. The outlook for the economy will also impact the focus and direction of the fiscal measures implemented by the government. The economic forecast provides the basis used to prepare the Fiscal Framework and to look ahead to the impact of policies on trends in future years.

A formal economic forecast is prepared at least three times per year: during the budget process in the spring; during the summer when the Fiscal Framework is built; and in the month of December. Throughout the remainder of the year an assessment of current economic conditions is provided in the internal monthly financial and economic review.

The process of preparing a formal forecast initially involves meetings between the Fiscal and Economic Analysis Branch, Planning and Statistics and Provincial Treasury to discuss the direction and trend of interest rates and to develop a common view. Discussions are also held by the Fiscal and Economic Analysis Branch with key ministry economists who have a "hands on" understanding of the critical sectors of the British Columbia economy. Meetings are held with economists from Forests, Energy Mines and Petroleum Resources and Economic Development, Small Business and Trade. The ministry economists not only provide an economic perspective of their industry but also provide "market intelligence" regarding factors affecting British Columbia's competitiveness in these critical industries.

A meeting is also hosted by the Fiscal and Economic Analysis Branch twice yearly with economists from the private sector in British Columbia and representatives from Crown corporations and from the federal government. The meeting takes place in Vancouver and is attended by approximately thirty

individuals in addition to ministry representatives. The meeting provides a different perspective of the province's economic situation which may otherwise be overlooked if the private sector were not consulted.

Based on the information gathered during the above meetings and the conclusions drawn, a set of assumptions are generated to be used as the input for the British Columbia econometric model. These assumptions are variables that are external to the model and include estimates of interest rates, exchange rates, Canadian Gross Domestic Product ("GDP"), the GDP deflator, Canadian Consumer Price Index ("CPI") and United States CPI. The assumptions are derived to be internally consistent with the scenario generated regarding how the economy will perform over the forecast period.

The British Columbia econometric model is managed and operated by the Quantitative Analysis Branch of the Planning and Statistics Division. The exogenous variables are entered as input to the model and endogenous variables, including consumption, investment, exports, imports, prices, wages and demand/demographic variables are generated as output by the model. The structure of the model follows that of most existing Keynesian models, with an enhanced supply side (production). The model was constructed for the purpose of forecasting the province's economy as well as to perform policy simulations over a five-year horizon.

When a new baseline forecast is required, the time required for the model to generate output has been up to two to three weeks. The lengthy period of time required to run the model is partially due to the fact that it is still in the development stage. The model has been in operation for approximately one year and is undergoing a process of refinement. The model's output is not the final forecast of economic variables. The staff of Economics and Policy and Planning and Statistics consult on adjustments to the forecast which are judged to be necessary. Final responsibility for the forecast rests with the Economics and Policy Division.

The process of re-running the model is time consuming and, in light of the time constraint of preparing the economic forecast, has limited the number of subsequent iterations. The final output from the model is reviewed and modified to reflect the judgement and special knowledge of the Fiscal and Economic Analysis Branch.

Generally, the economic forecast is that of the Economics and Policy Division. The exception is the forecast in the budget document which is released by the Minister of Finance and Corporate Relations. In this case, the economic forecast can be modified to reflect the specific views and/or opinions of the Minister or the Deputy Minister. In the past, adjustments made by the Minister of Finance and Corporate Relations to the economic forecast have been relatively minor and have always been within a confidence interval determined by the personnel in the Economics and Policy Division. Occasionally, the Minister has also revised

the revenue forecast to reflect his specific views. The revision by the Minister to the Fiscal and Economic Analysis Branch's revenue forecast has generally been immaterial.

b) Performance of the economic forecast

The primary economic variable which impacts government's budget forecast is British Columbia's growth in real GDP. Estimates of real GDP are provided by Planning and Statistics based on nominal GDP data provided by Statistics Canada. According to the latest reported numbers, the government has generally outperformed other forecasters over the past ten years in its ability to forecast real growth in British Columbia's GDP (Exhibit II). However, it should be noted that there have been large and frequent revisions to the real GDP estimates. The changes are due largely to changes in information provided by Statistics Canada. This indicates it is not only difficult to forecast where the economy is headed, it is also difficult to determine where it has been.

Exhibit II
British Columbia growth forecasts (% change in real GDP)

Forecast Growth Rates (Before the Fact)	1983	1984	1985	1986	1987	1988	1989	1990	1991	Average Deviation From Actual
Conference Board	2.9	2.5	2.3	4.6	1.6	2.2	2.9	2.7	(1.8)	2.2
Royal Bank	2.1	5.4	1.5	2.8	2.4	2.8	2.0	1.2	(0.8)	2.4
Bank of Nova Scotia	n/a	4.9	n/a	3.5	1.6	2.5	3.1	2.4	(0.6)	2.3
B.C. Central Credit Union	n/a	n/a	n/a	n/a	1.0	2.8	3.0	2.5	0.5	*
B.C. Ministry of Finance	2.0	3.0	2.5	4.0	1.5	2.7	3.0	3.0	(0.5)	2.0
Official PSD** Published "Actual" Numbers (After the Fact)										
1988 Publication	4.0	2.3	6.3	(1.1)	4.6	-	-	-	-	-
1989 Publication	0.6	3.1	6.4	0.2	5.0	3.6	4.2	-	-	-
New Publication	1.6	2.3	6.7	1.3	4.9	5.2	4.8	2.8	-	-

*Only five observations.
**Planning and Statistics Division.

Assuming that the figures about to be released by Planning and Statistics are the best representation of real GDP growth, the forecast prepared by the Ministry of Finance and Corporate Relations has been the most accurate of the various forecasters. This is illustrated in the following chart by comparing the average deviation in the forecast from actual real GDP growth.

c) Fiscal Framework

The Fiscal Framework is an attempt by the Ministry of Finance and Corporate Relations to take a medium-term status quo look at the fiscal position of the province. As previously discussed, the Fiscal Framework is prepared during the summer months and marks the beginning of the budget process.

The revenue forecast of the Fiscal Framework is prepared by the Fiscal and Economic Analysis Branch with input from the larger revenue ministries. The process of forecasting the revenue for the Fiscal Framework is similar to that followed for the budget. Large revenue ministries are provided with the economic assumptions and asked to prepare a five-year revenue plan. Taxation revenue is forecast by the Fiscal and Economic Analysis Branch.

In the case of the Fiscal Framework, the forecast of expenditures is prepared by Treasury Board staff analysts. The analysts build five-year "status quo" models of each ministry assuming no new programs are added, other than those already announced, and no program deletions other than those with a finite operating period. Where necessary, ministries are consulted to verify and/or provide information; however, the ministries are not directly involved in the forecast preparation. The models increase annual ministry expenditures to reflect the economic forecast and demographic variables.

The rationale for Treasury Board staff preparing the expenditure side of the fiscal framework is to ensure the forecast of expenditures is objective and not merely the ministries' "wish list".

2. The budget timetable

The primary method used by the government to both project its future financial position and to control expenditures is the budget process. Described in Appendix A are the various steps taken to prepare the annual budget and the approximate timing of each step.

3. Forecast of revenues and expenditures

a) Revenues

The government's forecast of revenues commences with the development of the Fiscal Framework which establishes the economic framework that will form the

basis of the forecast. The relative breakdown of revenue in the 1991/92 Budget was as follows:

	%
Tax revenue	62
Natural resource revenue	8
Contributions from government enterprises	4
Contributions from the federal government	15
Other	11
Total	100

Forecasts of government revenue growth depend on forecasts of economic performance. The British Columbia economy has been through a dynamic period during the past ten years. The relative importance of various industries in British Columbia's economy has changed substantially. Likewise, the profile of British Columbia's trading partners has changed, immigration has greatly increased and the age distribution of the population is much different today than it was five to ten years ago. Nevertheless, as previously discussed, the Fiscal and Economic Analysis Branch has outperformed other economic forecasters in its ability to predict real growth in British Columbia.

Historically, there has been a fairly close relationship between growth in nominal GDP and growth in government revenues. However, policy changes by the federal government regarding the Canada Assistance Plan and Established Programs Financing, have recently altered the historical relationship. The relationship has changed in recent years so that a given percentage change in nominal GDP now produces a smaller percentage change in revenue than it would have ten years ago. Another factor which affects revenue is provincial tax policy. A further factor is tax collection adjustments with the federal government. Because revenue collections are based on federal forecasts of tax bases and the provincial share which adjusts with a lag, the effect of lower GDP growth may not be realized until the following year.

Three primary factors that contribute to the difficulty of forecasting revenue can be summarized as follows:

- Uncertainty of British Columbia's GDP.
- Policy uncertainty of the provincial and federal governments and uncertainty of the federal forecast.
- Difficulty translating an economic forecast to a revenue forecast.

The revenue forecast is prepared within the Economics and Planning Division by the Fiscal and Economic Analysis Branch based on the economic forecast and current revenue measures. Larger revenue ministries provided the Fiscal

and Economic Analysis Branch with their forecasts of revenues. A detailed description of the various components that comprise government revenue, the factors which influence the level of revenue collected and a general description of how the forecast for revenue is prepared is provided in Appendix B.

Revenue Monitoring System

The Fiscal and Economics Analysis Branch uses an internal Revenue Monitoring System ("RMS") to assist in the monthly monitoring of revenues and preparation of revised forecasts. This system is used to prepare the revenue numbers reported in the Ministry of Finance and Corporate Relations' *Monthly Financial and Economic Report.*

The branch is currently developing a new RMS which is expected to be operational by the start of the 1992/93 fiscal year. The existing RMS has been in use since 1987.

The system is used to monitor and forecast revenues during a fiscal year as follows:

- At the beginning of each fiscal year, monthly calendarizations and full-year revenue estimates are entered manually into the RMS. Aggregate and full-year estimates are tied into the government's annual published estimates. The calendarizations are provided by ministries and are the "yardsticks' against which actual monthly and year-to-date revenues are compared. Currently, the revenue budget is not revised throughout the year.

- During the second week of each month, the Financial Management Branch of the Office of the Comptroller General provides a report on actual revenues for the year-to-date, which are entered into the RMS. The Comptroller General prepares this report in consultation with ministries and the Fiscal and Economic Analysis Branch.

- The RMS produces summary reports by revenue source at the same level of detail that revenue is reported in the actual Estimates. The reports show the monthly and year-to-date variances for each revenue source. An "implied" revenue forecast is calculated by the RMS for each revenue source for the full year, which can be used as a guide in preparing revised forecasts. The "implied" forecast is based on the actual year-to-date variances and the initial estimate of monthly revenues yet to be received.

The existing system is not set up to report revenue on a ministry-by-ministry basis. Thus, the Fiscal and Economic Analysis Branch cannot provide ministries with summary revenue reports to confirm actual figures and provide

regular updates of forecasts. These problems have led to the development of a new RMS.

The proposed RMS system will parallel the structure of the system currently used to monitor and forecast ministry expenditures.

Structurally, the proposed system is quite different from the current system, as it will be used to monitor and forecast revenues at the ministry level, as well as by revenue source. It is more detailed than the current system in that the individual revenue accounts will all be monitored separately, instead of at an aggregate level that now occurs in some areas (e.g. other revenues, miscellaneous federal contributions). This should improve the accuracy and efficiency of revenue analysis for these sources.

b) Expenditures

In general, expenditures are more predictable than revenues. While revenue is largely dependent on factors beyond the control of government, once the votes are passed by the Legislature, expenditure can be monitored and controlled. The exceptions are the entitlement expenditures such as health and income assistance.

The procedure for forecasting expenditures essentially follows that described in Appendix A in the steps undertaken to prepare the budget.

The expenditure budget is prepared in the form of the Estimates. The Estimates are put together by Treasury Board staff and approved by Treasury Board and debated in the Legislative Assembly. Once the Supply Act is passed approving the Estimates in full, the primary task is in monitoring the spending on an on-going basis.

Five ministries account for 83 per cent of the 1991/92 budget operating expenditures. The following breakdown of the 1991/92 budget estimates by percentage expenditure by function illustrates their relative importance to the operating expenditure budget:

		%
Health	$5,486	33
Education	4,482	27
Social Services and Housing	1,908	11
Transportation	1,271	8
Other	3,398	21
	$16,545	100

The monitoring process commences with a calendarization by the ministries of spending over the budget year. This calendarization forms the basis for the Comptroller General to monitor the year to date spending by the various

ministries. It also allows the Economics and Policy Division to identify when spending is out of line with the budget and anticipate over and under spending in the ministries.

The monitoring is dependent of the quality of information received from the ministries throughout the year. The information received by the Comptroller General is generally obtained from the Senior Financial Officer of each ministry. Four problems exist with this information:

- The first problem is the method in which the information is prepared. There is not a consistent accounting system used by the government ministries and some ministries have better systems to assess what they have spent relative to what has been approved. In addition, the province uses an accrual system of accounting; however, the recording of accruals is not consistent from one ministry to the next. While some ministries are quite sophisticated in their method of accruals, others are reported to do no accruals at all and most ministries are somewhere between the two extremes. The problem is compounded by the increased decentralization within ministries, so that information is no longer readily available within ministry headquarters. This issue makes monitoring the expenditures of the province relative to the approved estimate a difficult process.

- The second problem is that the Senior Financial Officer is not always aware of decisions that are being made by senior bureaucrats in the line ministry which will increase expenditures. To address this problem, personnel from Economics and Policy speak regularly with the Treasury Board staff analyst for each ministry. The Treasury Board staff analyst liaises with the Assistant Deputy Ministers and the Deputy Ministers to prepare any requests to Treasury Board for additional spending. By contacting both the Senior Financial Officer and the Treasury Board staff analyst, Economics and Policy try to effectively monitor expenditures within the ministries. However, if senior ministry officials are unaware of an issue, the problem can go undetected.

- The calendarization of budgets by ministries may not be a reasonable attempt to predict when the actual spending will occur. If this is the case, it is difficult to monitor whether expenditure pressures are building within ministries.

- The fourth problem is one that was discovered during the process of our financial review and is the subject of a separate issue report entitled "Lurking Expenditures". Lurking expenditures are expenditures that are probably unavoidable unless action is taken well in advance but that may not be budgeted for and may not have

been brought to the attention of either Treasury Board staff or Economics and Policy.

Two areas where actual spending can be expected to deviate from the voted appropriation is in the area of "automatic stabilizers" and spending on statutory authority.

Automatic stabilizers are expenditures in social service ministries that increase during a downturn in the economy. These expenditures are difficult to control and budget for.

Statutory expenditures are items such as flood relief and fire fighting. While Treasury Board approval is still required, there exists statutory authority to make the expenditures regardless of the cost. As at December 31, 1991, for 1991/92, the cost of flood relief was estimated at $43 million, an expenditure not budgeted for but that has the statutory authority to be made.

A formal procedure must be followed for approval of expenditures which are in excess of budgeted amounts and that do not have statutory authority. The procedure involves a request to the Lieutenant Governor to obtain a special warrant for expenditures "urgently and immediately required for public good." Expenditures by a ministry in excess of a voted appropriation require approval in principle by Treasury Board. A Minister requests the amount required for his/her ministry for a period of time. The request takes the form of a Treasury Board submission. Treasury Board reviews the request and, as required by statute, recommends approval to the Lieutenant Governor in Council ("Cabinet"). Cabinet then requests the approval of the warrant by the Lieutenant Governor.

An alternative to the above procedure allows Ministers to take proposals directly to Cabinet for approval. Such circumstances are difficult to forecast and can have an impact on the accuracy of the budget forecast. However, approval is still required by the Lieutenant Governor-in-Council.

An on-going problem encountered in monitoring expenditures is the tendency of Ministries to overestimate and overreport spending. As is the case in many budgeting exercises, there exists a "protect it or lose it" mentality. Therefore, expenditures are aggressively reported throughout the year, generally in excess of what actually will be spent. During the 1990/91 period, approximately $200 million less than the expenditure pressures identified were realized.

E. Basis of assessment

We assess British Columbia's process for forecasting its budget deficit and fiscal planning in two steps:

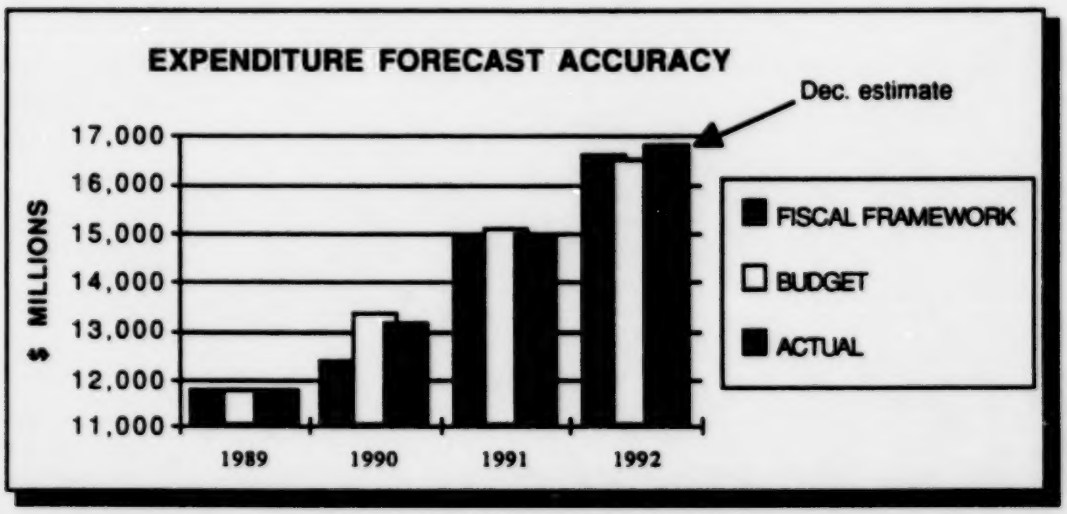
- How the province's original forecasts compared to actual results.
- How British Columbia's fiscal position looks relative to other Canadian provinces.

1. Review of British Columbia's forecasts

Appendix C provides an analysis of the province's forecasts for the past four years.

a) Expenditure forecast performance

The following graph illustrates the accuracy of the Ministry of Finance and Corporate Relation's expenditure forecast in both the Fiscal Framework and the budget over the past four years. The 1991/92 budget forecast for expenditures was 1.7% lower than the December 1991 revision (this revision does not take into account adjustments resulting from our review).



b) Revenue forecast performance

As the following table illustrates, beginning with 1980, actual revenues have been higher than budget for nine of the last thirteen years.

Revenues were significantly underestimated for the fiscal years 1988-1990 inclusive, due to the strong growth in the economy. This reflects the following two factors:

i) Because of the possibility of severe fiscal consequences that can occur in overestimating revenues, as was the case in 1982/83 and again in 1986/87, conservative forecasts are prepared to recognize the volatility of revenues.

ii) In an expansionary phase of the economy, it is difficult to estimate the magnitude of the increase.

Historical Revenue Performance ($millions)

Year	Budget	Actual	Difference	% Change From Budget
1979/80	4,567	5,707	1,140	24.96
1980/81	5,800	5,804	4	0.07
1981/82	6,636	6,903	267	4.02
1982/83	7,232	6,529	(703)	(9.72)
1983/84	6,771	7,344	573	8.46
1984/85	7,719	7,791	72	0.93
1985/86	8,166	8,180	14	0.17
1986/87	8,768	8,549	(219)	(2.50)
1987/88	9,370	10,088	718	7.66
1988/89	11,564	12,186	622	5.38
1989/90	12,987	13,435	448	3.44
1990/91	14,576	14,355*	(221)	(1.52)
1991/92	15,311	14,933**	(378)	(2.47)

* Preliminary actual.
** Revised Forecast (Dec. 1991).

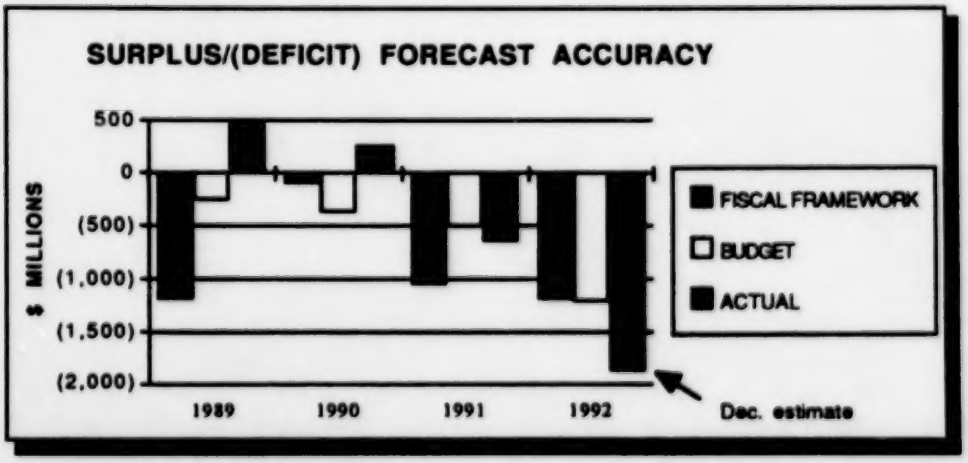
The following graph illustrates the relationship between budget and actual revenues over the past twelve years. While the historical performance of the forecast has been

impressive, the trend during the past two years raises concern regarding a fundamental change in the factors which comprise revenues.

* December 1991

c) Surplus/(deficit) forecast performance

The graph below illustrates the forecast of deficit presented in the fiscal framework, the budget and the actual deficit since 1989. This combines numbers for the General Fund and the Budget Stabilization Fund.



Given the magnitude of total revenues and expenditures, the variation of the forecast from the actual outcome has been relatively small over the past four years. However, the deviation in the budget surplus/(deficit) has been substantial over the same period. The actual budget surplus/(deficit) deviated an average of 102 per cent and 90 per cent from the forecast presented in the fiscal framework and budget respectively. This result is not surprising since it is the difference between two large numbers. Notwithstanding the difficulty in preparing an accurate surplus (deficit) forecast, it is the variable that receives the greatest attention by the media and the public.

d) Summary

British Columbia has succeeded in estimating expenditures with reasonable accuracy over the past four years. The province's variation of budget from actual in its revenue forecast over the same time period has averaged 3.2 per cent. The ability to forecast revenue within a small band of error and to control expenditures relative to budgeted estimates is an indication that the process of forecasting revenue and expenditure control is working relatively effectively. While, the variation in the forecast of the budget surplus/(deficit) has been significant a review of the explanations set out in Appendix C indicates that deviations from budget are often a result of spending decisions that are made after the budget is prepared and that could not be anticipated during the budget approved for a given fiscal year. Furthermore, during the fiscal year, these policy goals will change. This can lead to even further deviation between actual operational practices and the budgeted provisions.

The conclusion from a review of the accuracy of the budget forecasts is that whatever changes during the budget year are made which produce changes to the objectives of government, this leads to unpredictable changes in levels of expenditures. The review of the forecast process indicated a general lack of synchronization of the goals of government with the budget process.

2. The fiscal position of Canadian provinces

A comparison of British Columbia's fiscal position to that of other Canadian provinces is an indication of the fiscal planning and control of British Columbia relative to other provincial jurisdictions.

a) Debt levels

A consistent comparison of debt across provincial jurisdictions is complicated by differences in the method of delivery of provincial government programs. Programs that are provided directly by one provincial government, may be provided by a Crown corporation or various other levels of government in another province. The comparison is further complicated by the existence of financing authorities which borrow on behalf of their clients and whose debt is not direct debt of the province. British Columbia has three such authorities: the

British Columbia Educational Institutions Capital Financing Authority; the British Columbia Regional Hospital Districts Financing Authority; and the British Columbia School Districts Capital Financing Authority. Because of these differences, a simple comparison of direct debt shown in each province's budget document would not be appropriate as a relative measure of the debt for each province.

The Investment Dealers Association of Canada ("IDA") surveys all provinces and attempts to adjust provincial debt for differences in program delivery. The IDA defines the net public debt of British Columbia (less sinking fund payments) to include the debt of the social and government services Crown corporations and agencies. In 1991/92 the IDA shows net public debt of $9.8 billion for British Columbia.

The following table presents the Canadian provinces' net public debt as a percentage of GDP. Net Public Debt includes marketable bonds and treasury bills issued directly by the provincial government and borrowings from public sector pension funds. Net public debt issued on behalf of self-financing Crown corporations is excluded:

	Net Public Debt % GDP			
	1991-92	1990-91	1989-90	1988-89
British Columbia	12.0	9.6	9.2	10.8
Alberta	13.8	14.0	13.0	9.8
Saskatchewan	24.1	23.6	23.9	20.9
Manitoba	22.3	21.6	20.7	24.4
Ontario	18.3	15.0	14.4	15.5
Quebec	31.1	29.2	27.7	27.9
New Brunswick	24.9	24.2	23.8	25.4
Nova Scotia	28.9	27.9	27.8	26.5
Prince Edward Island	11.2	11.0	10.5	10.7
Newfoundland	41.6	41.5	40.2	40.4
Average Provincial Government	21.2	19.0	18.1	18.4
Federal Government	61.3	57.8	55.4	54.6
Both Provincial and Federal Governments	**82.5**	**76.8**	**73.5**	**73.0**

Source: Investment Dealers' Association of Canada (January 1992)

With the exception of Prince Edward Island, British Columbia has the lowest level of debt as a percentage of GDP among the Canadian provinces. Further, the level has remained a relatively consistent percentage of GDP over the past

four years. However, the recent trend in British Columbia's budget deficit as a percentage of GDP raises concerns regarding British Columbia's ability to control the growth in provincial expenditures relative to its growth in revenue. The following table indicates that while Alberta, Saskatchewan, New Brunswick, Prince Edward Island and Newfoundland expect their budget deficits as a percentage of GDP for the year 1991/92 to decrease from the 1990/91 level, British Columbia's is expected to increase substantially.

	Budget Deficit (Surplus) %GDP			
	1991-92	1990-91	1989-90	1988-89
British Columbia	1.5	0.9	(0.5)	(1.1)
Alberta	0.0	1.5	5.0	2.9
Saskatchewan	1.2	1.7	1.9	1.8
Manitoba	1.3	1.4	0.2	(0.3)
Ontario	3.4	1.1	0.0	0.6
Quebec	2.4	1.8	1.1	1.1
New Brunswick	1.3	1.4	0.2	0.6
Nova Scotia	1.9	1.7	1.7	1.6
Prince Edward Island	1.0	1.5	0.9	1.2
Newfoundland	2.0	2.9	1.3	1.5
Total Provincial Government	2.4	1.4	0.8	0.8
Total Federal Government	6.5	4.6	4.5	4.8
Total Provincial and Federal Governments	**6.9**	**6.0**	**5.3**	**5.6**

Source: Investment Dealers' Association

b) British Columbia's fiscal position

Net debt of the provincial government and its Crown corporations and agencies is expected to increase in 1991/92 by $3.4 billion to a total of $20.6 billion at year end. About one-half of this increase is direct borrowing for government purposes.

Forecast of Net Debt Outstanding at March 31, 1992 ($ millions)

Client	Net Debt at March 31,1991	Forecast Net Debt at March 31,1992	Change
Province Direct	4,725.9	6,570.7	1,844.8
B.C. Hydro	7,151.9	7,516.7	364.8
B.C. Buildings	514.3	559.6	45.3
B.C. Transit	1,227.6	1,344.7	117.1
B.C. Ferries	59.8	258.6	198.8
Financing Authorities	2,349.8	3,073.5	723.7
Other	1,172.2	1,269.5	97.3
TOTAL	**$17,201.5**	**$20,593.3**	**$3,391.8**

Net provincial debt has declined from its peak of 30.3 per cent of GDP at March 31, 1986. At March 31, 1992, this debt is expected to equal 26 per cent of GDP.

During 1991, the four major credit rating agencies in the United States and Canada confirmed the province's rating at their second highest levels and the highest among the Canadian provinces:

- Standard & Poor's—AA + (same as Ontario, higher than Alberta)
- Moody's—Aa1 (same as Alberta, higher than Ontario)
- Canadian Bond Rating Service—AA + (same as Ontario, higher than Alberta)
- Dominion Bond Rating Service—AA (same as Alberta, higher than Ontario)

c) Summary

The rating given to a province by the major bond rating firms is perhaps the most reliable indication of its fiscal position. British Columbia currently holds the highest rating among the Canadian provinces. Notwithstanding the above, the trend of expenditures of British Columbia over the past several years has come to the attention of the rating agencies.

The following is a quote from the December 12, 1991 report on British Columbia by Moody's Public Finance Department's "Rating News":

"The recent economic downturn, combined with continued high expenditure growth, has caused a deterioration in the province's financial performance. This led to an increase in tax-supported debt although its level remains well below the Canadian average. The ability to demonstrate control over spending will be an important consideration to future credit quality evaluations."

Immediate action on the part of the government is required to regain control of the province's fiscal position and maintain the confidence in the investment community.

With programs and services in place requiring approximately $17 billion annually to support, altering the trend in growth of expenditures will be difficult. The momentum for expenditures to keep increasing has been put in place by the initial establishment of the program. To maintain these programs as public awareness and utilization increases naturally leads to larger commitments of resources in the future. Overt action is required to rein in spending through allowing the timeframe of finite-life programs to lapse and to cancel ineffective programs.

F. Findings and conclusions

1. The adequacy of government's medium to long-term fiscal planning

a) The macro approach to the medium-term forecast

As discussed, the preparation of the fiscal framework involves a forecast of revenues and expenditures for five years. Treasury Board staff complete the forecast of the expenditure side of the forecast to maintain its objectivity and to prevent it from becoming the ministries' "wish list". The ministries have little involvement with the five year forecast.

As part of the 1992/93 budget instructions, ministries were required to present four year expenditure projections at the program level as well as revenue projections. This is the first time the request has been made of the ministries and is an attempt to look forward and anticipate the demands on the government from the programs and services being provided by the ministries.

Currently, little attempt is made to estimate the cost associated with future events if the outcome requires a political decision. Further, if the government views its negotiating position as being weakened by formulating a plan that includes the costs associated with possible future outcomes, it appears to ignore the contingency in its forecasts. For example, there is no attempt made to plan for the costs that will inevitably result from native land claims, and minimal

provision is made for the costs of negotiating the land claims. The same principle is true for a number of other "lurking expenditures".

The above comment is a criticism not of the current forecasting process, but rather of the lack of a policy that would take a mid to long-term approach to forecasting and co-ordinate it with government's social and fiscal objectives. The macro approach is useful for understanding how economic and demographic variables will impact existing programs, but it does not identify costs that will result from forces external to those programs.

We recommend:

- The Fiscal Framework procedure be expanded to look at micro as well as macro forces that will impact the future fiscal position and direction of the province. This could possibly involve an expansion of the process established this year in the budget instructions. The forecast would then be updated by the ministries during the summer months for inclusion within the Fiscal Framework.

- Implementing a policy of producing a five-year budget will have the additional benefit of forcing individual ministries to improve their approach to medium term budgeting as well as improving the planning and forecasting ability of the province.

b) Lurking expenditures

This point follows directly from the previous one. Outside existing programs, and in some cases within them, there is a lack of emphasis on determining what future demands may be on government resources resulting from factors other than changes in the economy or demographic trends. The need for this procedure is possibly outside the objectives of the annual budget and the Fiscal Framework. However, any prudent manager of a business, particularly one the size of the provincial government, would identify future potential costs, undertake an analysis of the likelihood of the cost being realized and formulate possible alternatives for minimizing the cost.

We recommend:

- Procedures be put in place to identify potential future costs and present alternatives of how to minimize such costs. Cost identification would require a process of "auditing" the ministries' budget forecasts several times a year. Logically, the group responsible for budget "audits" would be in Treasury Board staff.

- Estimates of future costs would require appropriate verification and any increase in the level of service provided would require justification.

While such a process would require the commitment of resources, the benefits associated with greater control and potential savings could be significant. Further, an audit would prevent the five-year forecast from evolving into the "wish list" format referred to above.

c) The absence of a central policy group

The role Treasury Board staff play in the budget process varies across the Canadian jurisdictions. In British Columbia, Treasury Board staff play an integral part in budget submissions and preparation of the estimates. While British Columbia appears to have the ability to maintain spending within or close to budgeted amounts, it is less clear whether the Estimates or "target" levels of spending are arrived at following a careful evaluation of the consistency of spending with government's objectives.

The current approach to budget formulation tends to focus on short-term measures at the expense of long-term goals. Part of the explanation for this is likely the lack of long-term government objectives. The Taxpayer Protection Act was not a credible attempt at long-term planning but apart from this statute, it is difficult to identify the overall vision in government's day-to-day delivery of services.

Clearly, in provinces with relatively small economies, fiscal policy would not constitute a central theme in the provincial budget process. Likewise, during periods of severe expenditure restraint, attention should be focused on reining in program spending as opposed to the implementation of fiscal programs.

The current trend in British Columbia's deficit is alarming, indicating that expenditure control should continue to play an important role in the budget process. However, the macroeconomic input is also important, particularly in light of the weak economic growth the province is experiencing. In this regard, it is beneficial for a policy branch to maintain a broader, long-term view of provincial policies and objectives.

The issue of the absence of a central policy group that would support Cabinet planning and decision-making is addressed in a separate issue report titled Structure and Process of Government. A summary of our recommendation is provided below.

We recommend:

- A Cabinet planning committee be established to formulate the goals of government, translate the goals into policies and ensure the budget process is framed around the stated government policies.

2. The adequacy of the procedure followed to forecast the province's budget deficit

The procedure implemented to prepare British Columbia's budget and control expenditures is generally thorough and effective. Notwithstanding the wide swings in the economic activity of British Columbia resulting from its natural resource orientation, actual revenue has rarely varied more than a few percentage points from the forecast. This would indicate that any internal or external forces that could interfere with the budget process have not materially affected the quality of the revenue forecast.

Likewise, expenditure monitoring and control as shown by the marginal variation between actual and forecast spending is impressive. The ability to effectively budget and monitor spending has culminated in British Columbia achieving the highest credit rating of all Canadian provinces.

Notwithstanding the foregoing, there are a number of issues which merit examination and/or action on the part of government.

a) The recent trend in British Columbia's budget deficit.

The deficit of British Columbia has moved from a surplus of $430 million in 1988/89 to the December, 1991 projected deficit of $1.9 billion. This forecast has been further revised following our review. (Refer to our overview report for a summary of our forecast.)

British Columbia has developed a fundamental imbalance between its revenues and expenditures which will not be eliminated with improved economic conditions. Corrective action must be undertaken to reverse the trend. If steps are not taken to limit spending and/or increase revenue, increasing debt loads will result. Higher debt levels lead to higher interest costs and will further impair the province's ability to reverse the trend.

We recommend:

- Steps be undertaken immediately to revise the Balanced Budget Plan and develop a realistic framework to correct the current imbalance between revenues and expenditures.

- The plan be developed within a mid to long-term strategic economic framework.

b) Zero-based budgeting

Zero-based budgeting and/or program evaluation is an extensive and time consuming process and, as a result, is not applied across British Columbia programs. Notwithstanding the effort required to evaluate programs and build

an entire new budget, certain provincial jurisdictions are applying zero-based budgeting to a revolving sub-group of programs from year to year.

Critically reviewing existing programs is one method of ensuring the resources of the province are employed in the most effective manner to achieve the objectives of government.

We recommend:

- a review be performed to determine the extent to which other jurisdictions are using zero-based budgeting, the degree of success experienced, the methods being used and an analysis of alternative strategies to apply zero-based budgeting to British Columbia's budget process.

c) The fiscal and economic analysis branch

The Fiscal Analysis and Policy Branch has primary responsibility within the Economics and Policy Division for preparation of the budget and its on-going monitoring. Further, the Branch prepares the province's economic forecasts. While the outputs produced by the Branch are significant, there do not appear to be the resources available for significant macroeconomic analysis and long-term strategic planning. While some long-term planning is completed in conjunction with Treasury Board staff, this is again, developed with an expenditure control perspective rather than a macroeconomic/strategic perspective.

We recommend:

- Additional resources be added, or a restructuring be undertaken, to strengthen the relationship between annual budget formulation and overall government policy-making and priority setting.

d) The aggregation of expenditures into fewer votes

As discussed in the body of this report, ministries can easily re-direct spending to another sub-vote within a given vote although not between votes. In light of this, there has been a trend towards fewer votes per ministry to increase the flexibility regarding spending at the ministry level. However, due to the increased discretion, money can be re-directed from an item that was determined by Treasury Board to be a need, to meet the specific concerns of a ministry. Potentially, this latitude could be used to increase future resource allocations.

For example, it has been suggested that during the 1980s school boards postponed needed maintenance and opted to spend the money on other operating costs within the same vote. Uneven spending on maintenance and capital spending has contributed to a substantial shortfall in maintenance expenditures and the necessity to undertake a substantial capital spending

program from 1992 through 1994. The length of time these expenditures on maintenance were postponed has reportedly resulted in the requirement for much more serious repairs and has left the province with no choice but to approve the funding to support increased borrowing by the school districts.

We recommend:

- A review of the number of votes allowed per Ministry and the degree of detail provided in the vote.

- As an alternative to the above, a review of the process required to re-allocate spending within a vote.

e) Procedure for forecasting expenditures with statutory authority

While the revenue side of the annual budget forms a revenue forecast, the expenditure side is driven by an approval process for funding ministries' expenditures and does not constitute a true or accurate forecast.

Expenditures that have statutory authority, such as flood relief, spending on forest fire suppression and provisions for doubtful accounts, are generally not estimated. Typically, funds are required to some degree for these expenditures and some years the cost is substantial. During the current year, the unbudgeted cost of flood relief and control is estimated at $42.9 million, the unbudgeted cost of the general election is estimated at $13.2 million and the unbudgeted cost of fire suppression is estimated at $11.0 million.

It is customary for ministries not to include all expenditures with statutory authority in their budgets. The effect is that the accuracy of the budget as a forecast and its effectiveness as a planning tool is diminished. An attempt to compensate for this problem is made by including an allocation in the budget for contingencies.

We recommend:

- Expenditures with statutory authority be included in the annual budget. Estimates should be based on the most likely annual expenditure given historical experience and current events.

f) Location and independence of planning and statistics division

As previously discussed in this report, the Fiscal and Economic Analysis Branch is responsible for producing the province's economic forecast. As part of this process, discussions are held with personnel from the Quantitative Analysis Branch of Planning and Statistics. The Quantitative Analysis Branch

is responsible for maintaining and operating an econometric model of the British Columbia economy.

A number of problems have been identified with the model, which is still under development. Generally, the reliance on large econometric models as economic forecasting tools has diminished over recent years. Econometric models may have more value simulating the effects of significant policy changes. Further, the use of econometric models imposes a discipline on economists by forcing a mutually consistent group of assumptions regarding a forecast and/or the effect of policy shocks. In addition to the issues discussed earlier in this report regarding the econometric model, the following two problems have been identified:

- The physical separation of the Fiscal and Economic Analysis Branch and the Quantitative Analysis Branch makes communication between the personnel of the two groups difficult. Closer proximity would allow the branches to work together towards developing a model with broader uses and applications. Given the physical location of the two organizations, it is unlikely that they will work together towards this goal.

- The staff in Quantitative Analysis Branch are not union "excluded" personnel. The union status of the Quantitative Analysis Branch is inconsistent with the policy applied to Economics and Policy and Treasury Board staff with respect to the budget process.

We recommend that:

- Consideration be given to moving the Planning and Statistics Division to 617 Government Street. If insufficient space is available for the entire division to move, a review of the benefits and costs of moving only the Quantitative Analysis Branch should be undertaken.

- Those staff in the Quantitative Analysis Branch that are involved in the budget process should be excluded personnel.

g) Ministry expenditure reporting

The process of monitoring Ministry expenditures is complicated by the inconsistency across ministries in the quality of information provided to the Fiscal and Economic Analysis Branch. Specifically, ministries have developed a variety of methods of accruing expenditures which vary from no accruals at all to sophisticated approaches. The existence of this problem diminishes usefulness of the calendarization process.

We recommend:

- Resources be applied to establishing consistent reporting systems across government ministries. This issue is dealt with in significant detail in the Accounting Policies Issues report.

Appendix A

Budget Timetable

1. Fiscal Framework — July/August

The budget process commences with the Fiscal Framework. It provides the economic, demographic, balance sheet, revenue and expenditure projections and assumptions on which to build the revenue and spending estimates. The Fiscal Framework is co-ordinated and largely prepared in co-operation between Economic and Policy and Tresury Board Staff. It is typically presented to Cabinet and Treasury Board by the Ministry of Finance and Corporate Relations in July or August.

2. Target Funding Levels/ Budget Instructions — August/September

Following receipt of the Fiscal Framework, the Treasury Board follows shortly with the target funding levels for the ministries. For the past several years, targets have been established as a percentage of the ministries' previous years Estimates adjusted to reflect program transfers, non-recurring expenditures, annualization of costs for programs that began mid year, and Treasury Board or Cabinet decisions approving increases/decreases to the base. Budget instructions are also distributed to the ministries and their budgeting process formally commences.

3. Budget Submissions — August

The ministries' budget preparation typically begins in August. This year, target levels have been decreased for some ministries to below 100 per cent of last year's target. In addition, the Budget Instructions requested that at least three programs or packages of discrete activities, accounting for expenditures of at least 10 per cent of a ministry's 1992/93 target funding level must be identified for possible elimination. The Budget Instructions also requested issue papers that identify savings of 2 per cent and 4 per cent of non-salary operating and asset acquisition costs. Included in the Budget Instructions are the economic assumptions to be used by the ministries to prepare the budget submissions.

The ministries present their proposals to Treasury Board or its designate for approval. Ministries re-submit their budgets as decisions are made. Controversial issues can be referred to cabinet for decision. In certain situations, approval of the Request for Spending (Votes) can involve changes to legislation.

Ministries prepare budget submissions on a program basis, generally at a vote or a sub-vote level. Each ministry has at least two votes. There is a preference to having fewer rather than more votes as appropriated funding is easily re-allocated within a vote, providing more flexibility to the ministry. Funds cannot be moved between votes and to spend an amount in excess of the approved vote requires a proposal to Treasury Board.

In addition to the budgets for Target Funding, ministries can also present Issue Papers. An Issue Paper is a funding request over and above established target spending. Also as part of the ministries' budget submissions are their respective revenue plans.

Capital Plan Submissions are forwarded to Treasury Board Staff as part of the budget submission process. Ministries' Capital Plan Submissions are expected to follow a five-year plan to anticipate need. Each ministry's request is analyzed on the basis of need to maintain the capital stock of the ministry as a public asset, the demand for service such as the need to provide schools, and new program policy decisions which add to or substitute for existing facilities.

4. Economic and Revenue Forecast — November/January

Concurrent with the preparation by the ministries of their budget submissions, the Economics and Policy Division commences work on the economic forecast and status quo revenue forecast.

5. Preparation of Revenue Binder — December/January

The revenue options are presented to the Minister of Finance and Corporate Relations in a Revenue Binder. The Revenue Forecast involves changes to revenue measures on the part of the ministries and the Minister of Finance and Corporate Relations. The ministries make changes with respect to the cost of licenses and fees. The Minister of Finance and/or the Premier make changes to tax rates.

6. Treasury Board Reviews Budget Submissions/ Decisions Conveyed to Ministries

November thru January

During the month of December, Treasury Board reviews the ministries' budget submissions and conveys its preliminary decisions on expenditures, fees and licences to the ministries. In the Economics and Policy Division, the economic and revenue forecasts are completed and the Minister of Finance and Corporate Relations approves the budget speech outline. Economics and Policy Division commences work on the budget speech and coordinates the production of the budget document.

7. Final Preparation for the Budget Address — January/February

During the month of January and February Treasury Board finalizes outstanding budget and cross-government issues. Treasury Board staff convey the final decisions, and instructions for completion of budgets to the ministries. Treasury Board reviews pre-approval requests.

Also during February, Economics and Policy Branch and Treasury Board staff finalize the Budget and Estimates.

Later, in March, the Minister of Finance and Corporate Relations delivers the budget address and tables the Estimates, Balanced Budget Plan, Debt Reduction Plan, Balanced Budget Progress Report and Interim Financial Statements. Debate begins in the Legislative Assembly on individual ministry estimates. Following the Estimates debate, the Supply Act is passed approving in full the amounts submitted in the Estimates.

8. Calendarization of Revenue and Expenditures — April

As a final step in the Budget Process, ministries are required to prepare calendarized revenue and expenditure budgets consistent with tabled Estimates and forward these to the Comptroller General. These calendarized budgets provide a control mechanism for the government to monitor spending and revenue by comparing the year-to-date results of various ministries to their respective budgets.

➢ On-going Monitoring of Ministries — April through March

The actual performance of the various ministries is monitored against calendarized budgets throughout the year by the Ministry of Finance and Corporate Relations. An internal monthly Financial and Economic Report is produced that examines the government's operating performance and outlook. This report also identifies spending pressures that are becoming evident in the various ministries, as well as possible changes to revenue. A publicly available Quarterly Financial Report is produced three times per year.

Appendix B

Revenue Components

Presented below are descriptions of the various components of revenue:

1. Tax Revenue

Personal income taxes ("PIT"), corporate income taxes ("CIT"), social services tax and property purchase tax comprise 52% on the 1991/92 revenue budget. The breakdown of their relative importance is as follows:

PIT	28%
CIT	4
Social Services Tax	14
Property Purchase Tax	6
Contributions from Federal Government	15
Other	33
	100%

➤ PIT/CIT

In the case of PIT and CIT (32% of the revenue budget), the basis of the Province's estimates is provided by the federal government. In February, prior to release of the Provincial Budget, the federal government provides the Province with an estimate of taxes which will be collected for the current tax year. In the case of PIT, British Columbia's share of the national basic federal tax ("BFT") is estimated by its actual share for the previous year, after adjustments for the impact of current year tax changes. In the case of CIT, British Columbia's share is estimated by its actual share two years earlier, after adjustments for the impact of current year tax changes.

Payments to the Province commence in March. The federal government updates its estimate of the total BFT and Corporate Taxable Income ("CTY") during the summer months and in the late fall. Payments to the Province are adjusted following each estimate.

Because the payments to the Province are made on the basis of the federal government's estimates of BFT and CTY as well as an estimate of British Columbia's share of PIT, it is necessary to make periodic prior year

adjustment payments. The adjustments are made once a year during late March. For example, in the case of CIT, the provincial government will either make a payment to the federal government or receive a payment from the federal government during March 1992, representing the difference between the federal government's CIT payments during 1990 and the amount of revenue which has actually been assessed for the 1990 taxation year as at December 31, 1991. These payments can be large and have ranged from a $113 million payment from the federal government to the Province for the 1989 taxation year, to a $66 million payment from the Province to the federal government for the 1984 taxation year.

This method of estimating taxes accruing to the provinces is partially responsible for Ontario's large error in estimating its 1991/92 budget forecast. Unlike British Columbia, Ontario collects its own CIT, though the federal government collects PIT on behalf of Ontario. Based on the federal government forecast update in November, the Ontario government has lowered its 1991/92 forecast of $16.0 billion for PIT revenue by $2.1 billion (down 12.5 per cent). This reduction reflects the impact of the lower national BFT forecasts for 1991 and 1992 as well as a decline in Ontario's share of national BFT, from 46.2 per cent for the 1989 tax year to 44.0 per cent for the 1990 tax year.

Although British Columbia was also affected by the decline in the federal government's estimate of national BFT, the impact was moderated by an increase in the Province's share of national BFT from 12.6 per cent to 12.9 per cent. The Province was impacted by a reduction of the estimate of CTY resulting in a decrease in expected CIT payments of approximately $59 million.

- **Social Services Tax**

The social services tax ("SST") is primarily driven by consumer and corporate spending. The forecast is arrived at using estimates of British Columbia retail sales and capital investment by business. The split between consumer and corporate is assumed to be approximately equal.

Changes such as implementation of the federal goods and services tax ("GST") have complicated the forecast of SST increasing the difficulty of constructing a consistent series of retail sales data. Monitoring the collection of the tax is also difficult as a result of the large number of outlets collecting the data and the lag in receiving the information.

- **Property Tax**

Property tax makes up 6 per cent of the 1991/92 revenue forecast. This tax is relatively predictable as the Province is responsible for setting the rates and in most cases payment of the tax is assured.

➤ **Fuel Tax**

British Columbia's fuel tax is indexed to the Vancouver gas component of CPI. The forecast of this tax, which constitutes approximately 4 per cent of the 1991/92 revenue budget estimate, is based on expected growth in volume as well as the gas component of CPI.

➤ **Tobacco Tax**

British Columbia's tobacco tax rate is indexed to changes in the cigarette component of the Vancouver CPI and is adjusted every six months. In the 1991/92 budget, the tax rate on a carton of 200 cigarettes was raised from $13.28 to $16.00 on May 22, 1991. In addition the indexing formula was revised to ensure larger increases. The adjustment on September 1, 1991 increased the rate to the level of $18.80. The 1991/92 estimate of tobacco tax revenue was 3 per cent of total revenue.

➤ **Other Tax Revenue**

Other tax revenue includes property purchase tax and miscellaneous other taxes responsible for 3 per cent of the 1991/92 budget revenue estimate.

2. Natural Resource Revenue

Natural resource revenue includes revenue from petroleum and natural gas, minerals, forests and water and other. In total, revenue from natural resources comprises 8 per cent of the 1991/92 revenue budget.

Natural resource revenue is estimated by the various ministries responsible for collection using economic assumptions supplied by Economics and Policy.

➤ **Petroleum and Natural Gas**

Revenue from petroleum and natural gas is generated through royalties, permits and fees, the sale of welling rights and annual renewal fees. Several of these factors are quite volatile and can be difficult to forecast.

➤ **Minerals**

The majority of mineral revenue is from the mining tax which, like petroleum and natural gas, is also quite volatile.

➤ **Forests**

Forests are the largest component of natural resource revenue. Tax is generated from logging taxes, timber sales and stumpage. Target levels for

these taxes are based on anticipated lumber production and the estimated CPI growth.

➤ **Water**

Water rentals are a unit charge on water used by the power producers in the province. The target level is based on the amount of hydro used in the previous year with a factor applied to it. In 1985, the factor was frozen for five years. This freeze was carried over into 1991. For the purpose of the 1991/92 budget forecast, it was assumed that the freeze continues into 1992. A rate increase of 15 per cent was recently approved effective January 1, 1992.

3. Other Revenue

Other revenues include medical service plan premiums, lottery funds, other fees and licences, investment earnings and miscellaneous revenue. This classification accounts for 11 per cent of the 1991/92 revenue budget. In general, the components of other revenue are predictable, moving with demographic variables such as population growth.

4. Contributions From Government Enterprises

Government enterprises make up a relatively small component of the revenue budget with a 1991/92 contribution of four per cent. Revenue from government enterprises is primarily derived from dividends received from the Liquor Distribution Branch ("LDB") and B.C. Hydro.

➤ **LDB**

LDB receives its profits from sales. All tax on liquor is SST, so the LDB's profit is entirely from a mark-up over cost. Agreements such as Free Trade with the United States have decreased the predictability of LDB transfers of earnings. Mark-up policies continue to change and alter the relative consumption of various brands and types of alcohol.

➤ **B.C. Hydro**

Dividends received by the Province from B.C. Hydro are calculated in accordance with a formula which incorporates a number of financial ratios. The forecast of B.C. Hydro dividends is produced by B.C. Hydro for the government.

Currently, B.C.Hydro has a rate application filed with the B.C. Utilities Commission requesting a rate increase of 7 per cent to be implemented January 1, 1992, 7 per cent to be implemented April 1, 1993 and 5 per cent on April 1 in the following year. The existing policy allows a 1 1/2 per cent rate

increase on April 1 of each year. Depending on the outcome of the rate hearing, the level of dividends received in the future from B.C. Hydro could increase considerably. For example, the estimate by B.C. Hydro of its 1993 dividend is $70 million if there is no rate increase, and $170 million if there is.

5. Contributions From Government Enterprises

➢ Established Programs Financing

Established Programs Financing was instituted in 1977 to replace the 50/50 Federal/Provincial cost-sharing mechanism for financing medical-care, hospital insurance and post-secondary education. It has always been the largest federal transfer. In 1991/92, its values will be $2.3 billion to British Columbia: this is made up of a cash transfer of $1.1 billion and a tax point transfer of $1.2 billion. The established programs financing contribution is calculated as a per capita amount and was increased annually in accordance with the growth in the national economy. During 1990, after a series of federal actions which reduced federal contributions below the original formula, the federal government announced in its 1989 budget that commencing in 1990/91 the annual escalator would be reduced by a further 1 per cent. The 1990 budget exacerbated the situation with a two-year freeze in the per capita growth in the established programs financing transfer. The 1991 budget extended the freeze an additional three years to 1994/95. The five-year impact of the pre-freeze measures and the five-year freeze is $5.1 billion.

The original estimate in the 1991/92 budget forecast of funds received from established programs financing was $1,187 million. The most recent forecast of revenue from this source is $1,122 million, down $65 million.

It is possible that the federal government will continue to reduce its participation in cost-sharing programs. Such policy changes are impossible to predict accurately and add further uncertainty to the province's forecast.

➢ Canada Assistance Plan

The Canada Assistance Plan ("CAP") agreement was designed to outline the terms and conditions relating to the transfers pertaining to social assistance and persons in need. The CAP had traditionally been shared on a 50/50 basis. The 1990 federal budget placed a limit of 5% per annum on gross of CAP transfers to the provinces not receiving equalization payments. These restrictions were extended in the 1991 budget to 1994/95. It is anticipated that the extension is indefinite.

The British Columbia government appealed the federal action on the grounds that it violated a contractual agreement. The Supreme Court of Canada found

in favour of the federal government and upheld the 5 per cent limit on CAP growth.

The Supreme Court of Canada's decision reduced the budget estimate for revenue from CAP from $908 million to $752 million, a decrease of $156 million.

Appendix C

Forecast Accuracy

The following tables provide summaries of changes made to the forecast of revenues and expenditures from the initial fiscal framework to the tabled budget which is then compared with the actual budget surplus/deficit. Explanations of the major causes for the revisions are also provided. The forecasts exclude Budget Stabilization Fund transactions.

This information was prepared by the Ministry of Finance and Corporate Relations and, to the extent practicable, verified by us. It supports the view that, generally, the monitoring of forecast revenues and expenditures is reasonably good.

➤ **1991/92**

	1991/92 ($ millions)		
	Revenue	Expenditure	Surplus/ (Deficit)
Fiscal Framework (June 1990)	15,395	16,611	(1,216)
Caucus Committee	15,260	16,761	(1,501)
1991 Budget (May 1991)	15,311	16,545	(1,234)
Revised Forecast (December 1991)	14,933	16,834	(1,901)
DIFFERENCE:			
Budget Compared to Forecast	**378**	**(289)**	**667**
Fiscal Framework Compared to Forecast	**462**	**(223)**	**685**

Explanations:

Budget:

- GDP growth fell from 1.5 per cent in the fiscal framework to (0.5) per cent in the budget.
- New federal forecast information resulted in downward revisions to PIT revenue and CIT revenue. Continuing weakness in the economy led to

downward revisions to natural resource revenue and lower than expected revenues caused a downward revision to tobacco tax.

- Federal CAP contributions were raised $156 million based on a decision of the B.C. Court of Appeal and a letter received from the federal government. New revenue initiatives totalling $209 million were also added to the forecast.

January, 1991 Forecast:

- The revised forecast for revenue is down $378 million from the budget estimate because of downward revisions to Canada Assistance Plan payments (resulting from the August 15 decision of the Supreme Court of Canada), corporate income tax and natural resource revenues, and the B.C. Hydro dividend.

- The revised expenditure forecast is up $289 million from budget mainly due to higher spending for income assistance, Medical Services Plan and, flood relief, tree fruit assistance and South Moresby Park compensation payments.

➤ **1990/91**

	1990/91 ($ millions)		
	Revenue	**Expenditure**	**Surplus/ (Deficit)**
Fiscal Framework (July 1988)	13,952	15,029	(1,077)
Caucus Committee(Nov.1988)	14,145	15,645	(1,500)
1990 Budget (April 1990)	14,576	15,100	(524)
Actual	14,377	15,016	(639)
DIFFERENCE:			
Budget Compared to Actual	**199**	**84**	**115**
Fiscal Framework Compared to Actual	**(425)**	**13**	**(438)**

Explanations:

Budget:

- GDP growth increased from 2.5 per cent in fiscal framework to 3 per cent in budget.

- New federal forecast information resulted in upward revisions to PIT and CIT revenue. Continuing strength in the economy led to increased social service tax revenue. Also added to the forecast were additional dividends from B.C. Petroleum, B.C. Rail, BCBC and B.C. Systems Corporation.

- Expenditures were up slightly due to higher approved spending for Education and Environment/Forests offset by lower expenditure for Transportation and Highways.

Actuals:

- Slower than expected economic growth in 1990 caused revenue to be $221 million below the 1990 budget estimate. Lower collections of corporation income, social service and property purchase taxes offset higher than expected PIT collections. Natural resource revenue was below budget due to lower minerals and forests revenue, while EPF cash contributions fell because of higher than expected PIT collections and the effect of a federal contribution freeze.

- Real GDP for the year was 2.8 per cent (versus 3 per cent in the budget), while growth in retail sales and investment spending declined to 6.2 and 11.2 per cent, respectively.

➤ **1989/90**

	1989/90 ($ millions)		
	Revenue	**Expenditure**	**Surplus/ (Deficit)**
Fiscal Framework (July 1988)	12,305	12,424	(119)
Caucus Committee (Nov. 1988)	(2,070)	12,362	14,432
1989 Budget (March 1989)	12,987	13,362	(375)
Actual	13,435	13,190	245
DIFFERENCE:			
Budget Compared to Actual	**(448)**	**172**	**620**
Fiscal Framework Compared to Actual	**(1,130)**	**(766)**	**364**

Explanations:

Budget:

- GDP growth forecast changed from 2 per cent in fiscal framework to 3 per cent in the budget.
- New federal forecast information resulted in upward revisions to PIT and CIT revenue. Stronger economic growth in in-migration resulted in increases in social service tax and MSP revenues. Hydro dividends were also added to the forecast.
- Expenditures up due to higher approved spending for Education (up $210 million due to Royal Commission), Health (up $200 million), Social Services (up $150 million) and Transportation and Highways (up $250 million due to Freedom to Move).

Actuals:

- Actual revenue for 1989/90 was $448 million higher than budget, mainly due to the stronger than expected economy. Strength in the provincial economy led to higher than expected collections from PIT, social service and property purchase taxes, partially offset by declining CIT revenue. Real GDP growth for the year was actually 4.8 per cent (versus 3 per cent in the budget), while retail sales and investment spending grew by 9.6 and 25.3 per cent respectively.

➤ **1988/89**

	1988/89 ($ millions)		
	Revenue	**Expenditure**	**Surplus/ (Deficit)**
Fiscal Framework (June 1987)	10,582	11,802	(1,220)
Caucus Committee	N/A	N/A	N/A
1988 Budget (March 1988)	11,564	11,835	(271)
Actual	12,186	11,767	419
DIFFERENCE:			
Budget Compared to Actual	**(622)**	**68**	**690**
Fiscal Framework Compared to Actual	**(1,604)**	**35**	**(1,639)**

Explanations:

Budget:

- GDP growth forecast changed from 2.5 per cent in fiscal framework to 2.7 per cent in the budget. Retail sales and investment spending forecasts changed from 5.5 per cent and 8.7 per cent to 7 per cent and 13 per cent.

- New federal forecast information resulted in increases to PIT and CIT revenue. Stronger economy resulted in increase to social service tax revenue forecast. New revenue initiatives totalling $355 million were added to forecast.

- Expenditures were up slightly due to increased Health and Education approvals.

Actuals:

- Actual revenue for 1988/89 was $622 million higher than budget, mainly due to the stronger than expected economy. GDP growth for the year was actually 3.6 per cent, while retail sales and investment spending grew by 8.6 per cent and 17.9 per cent, respectively.